



TECHNICAL ANALYSIS & TRADING METHODOLOGY

by Howard G Wright

I have been a market trader and a practitioner of Technical Analysis for more than thirty years.

Experience has taught me that in spite of the increase over the years in the speed in which news is delivered and deciphered, and the sophistication of modern computer software, the most consistent and successful method of trading the financial markets is one which is founded upon subjective Technical Analysis.

For those who may be unfamiliar with this term, Technical Analysis is the forecasting of future price movements based on a study of past price-action. This basic concept applies to any tradable instrument where the market price is influenced by the forces of supply and demand –such as currencies, precious metals, commodities and stocks.

Where FX24 is concerned, it specifically includes the Euro/US Dollar, British Pound/US Dollar, Gold, Oil, and the US S&P 500 index.

Because Technical Analysis is subjective and not a science with established laws and principles, no two analysts will necessarily see the same patterns, or arrive at the same conclusions. Is the cup half-empty, or is it half-full? The answer is always in the eye of the beholder. As such, it rarely results in absolute predictions about the future –in the same way that weather forecasting, despite modern technology, still cannot predict exactly when and where a storm will strike. But because history, whilst rarely repeating itself, often rhymes, Technical Analysis is able to provide a high measure of probability and, in so doing, help traders, investors and financial managers anticipate price-wise what is most likely to happen.

The price of anything is in essence the end product of a battle between the forces of supply and demand. These primary forces are determined by a collection of human beings made up of Bank traders, Fund managers, Corporate Managers, Institutional investors, and a plethora of individual private traders and end-users, all of whom will have considered and discounted everything under the sun, and declared via brokers or an on-line trading platform a willingness to buy, or to sell, at a specified price. Whilst Economists and Fundamental Analysts generally view this human driving influence as roughly 30% psychological, and 70% logical, Technical Analysts, like myself, generally hold the opposite view, and regard it as 70% psychological and 30% logical. Clearly this subject is open for debate. But there is no denying that the price of any security or instrument reflects the sum value perception of all the market participants at any given moment in time.

As a disciplined practitioner of Technical Analyst, I concentrate on 'what' rather than on 'why!' By focusing on the price and only on the price, I am able to strip away the background noise and apply an unbiased and direct approach. Through the discrete use of computer produced 'bar charts' and 'point & figure' charts, which provide a visual representation of market price-action, I am able to identify what I consider to be the critical support and resistance levels in the market. Whilst both types of chart evidence potential price break-out levels, 'bar' charts, which show price 'movement' measured against 'time', have the added benefit of reflecting market momentum (also known as price velocity). When there is an obvious disparity in the rate of price

appreciation and depreciation, 'bar' charts will, as a result, show both the weak and the strong sides of the market, and therefore the strength of the prevailing or evolving market trend. Conversely, 'point & figure' charts, which plot market movements over specified price scales and omit the element of time altogether, filter out much of the 'noise' and, as a result, provide a picture of the market that is less cluttered, and thus easier to read. When used in conjunction, I find these to be the most effective tools in my 'technical' tool-box.

The aforementioned 'support' and 'resistance' levels, deemed as 'critical', become evident following periods of market consolidation or range trading, where the price has been fluctuating within a recognized band due to the attainment of temporary equilibrium in the underlying forces of supply and demand. When the market price eventually moves outside of the identified range, it signals that one side of the market is beginning to gain the upper hand. If the price rises above the upper band of the range, it evidences that demand is increasing and supply is waning. Conversely, if the price falls beneath the lower band of the range, it shows that supply is increasing and demand is waning.

By determining which of these forces is prevailing I am therefore able to focus directly on the bottom line: What is the price? Where has it been? And now more importantly, where is likely to move in the future?

Technical Analysis is particularly useful in assessing the timing of an appropriate entry level. Many institutional traders use Fundamental Analysis to decide what to buy, and Technical Analysis to decide when to buy. By simply waiting for a 'break-out' above a 'critical resistance', or below a 'critical support', either on an intra-day price violation, or more reliable, a daily closing basis (typically the close of the New York market), it is possible to substantially improve returns –and, more importantly, minimise risk. As I like to remind my customers, trading is a marathon, not a sprint; and as such stamina and patience count for a lot.

There is, however, a more complex side to Technical Analysis that has more to do with mathematics, than economics. You might think it is a modern day methodology that has been cultivated in the wake of advancing technology. But you would be wrong. Because, its secrets were unearthed in the garden of an obscure mathematician 700 years before the first 'ticker-tape' or 'bar' chart appeared. By meticulously plotting the reproductive cycles of rabbits, a citizen of 13th century Pisa, Italy, by the name of Leonardo Fibonacci, arrived at the number sequence that now bears his name –the same sequence of numbers that was known to the builders of the pyramids and of many other classical structures. This numeral string suggests that the global financial markets are, in reality, part of a timeless universal design. Ask any mathematician or modern day physicist and he will most likely agree. If you can accept that there are mathematic constants that reappear in different ways within the physical universe, it is then just a small logical step to assume that human beings will necessarily act within these archetypal parameters. To the disciples of a 19th century American accountant Ralph Nelson Elliott, market gyrations are not random; but instead come in waves conforming to the ratios embedded in the Fibonacci series 1,2,3,5,8,13 -and so on, to infinity. After the first four, the ratio of any number to the next approaches a ratio of 0.6180 –known as the 'golden mean ratio'. This ratio is apparent in everything, from the spirals in the shell of a snail, to the dimensions of a DNA molecule. Science has subsequently proved that Fibonacci-governed processes affect timing right down to the tiniest structures within the human brain, and that human response to the world's financial markets is just a short evolutionary jump from the most basic of primal animal instincts –fight, or flight!

After more than 30 years as an Analyst and Trader in the global financial markets with average annualized un-leveraged returns during this time in excess of 13.0% (see Past Trading results), I still see myself as the apprentice, not the master. Because, every day the subtle changes in the behavioural patterns of the market teach me a new lesson.

As such, I am continually fine-tuning and adapting my proven trading methodology in a way that combines Technical Analysis, Fundamental Analysis, and Experience, to optimum effect. Although this methodology embodies strict disciplines on entry points and stop-loss levels, and involves the use of sophisticated computer technology, it is NOT an automated 'black-box' trading system. Whereas technically driven trading is heuristic in nature (an evolving and durable experienced based technique that helps in problem solving and learning), 'automated trading systems' have a shelf-life! As a result, all of them, without exception, ultimately fail. Therefore, whilst I do not profess to have an infallible trading methodology, I can rightly claim that I have one that has worked very successfully for the past 21 years.

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